

# **EXHIBIT 2**

**THE METROPOLITAN SEWER DISTRICT  
OF GREATER CINCINNATI**

**FINANCIAL STATEMENTS**

for the years ended December 31, 2002 and 2001

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**THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI****TABLE OF CONTENTS**

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**Foxx & Company**  
Certified Public Accountants

## INDEPENDENT AUDITORS' REPORT

The Honorable Board of County Commissioners  
Hamilton County, Ohio

We have audited the accompanying financial statements of the Metropolitan Sewer District of Greater Cincinnati (MSD), as of and for the years ended December 31, 2002 and 2001 as listed in the table of contents. These financial statements are the responsibility of MSD's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Metropolitan Sewer District of Greater Cincinnati, at December 31, 2002 and 2001, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1, the financial statements present only the financial position of MSD and are not intended to present fairly the financial position of Hamilton County, and the results of its operations and cash flows of its proprietary fund types in conformity with generally accepted accounting principles.

As described in Note 12, the District adopted Governmental Accounting Standards Board Statements Nos. 34, 37 and 38 as of and for the year ended December 31, 2002.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 18, 2003 on our consideration of MSD's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an

integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the financial statements taken as a whole. The Management's Discussion on pages three to seven, is presented for purposes of additional analysis and is not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

A handwritten signature in black ink that reads "Foxx & Company". The signature is fluid and cursive, with "Foxx" on the left and "& Company" on the right, connected by a diagonal stroke.

Cincinnati, Ohio  
April 18, 2003

## **Management's Discussion and Analysis**

### **OVERVIEW OF THE FINANCIAL STATEMENTS**

This discussion and analysis is intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements are comprised of two components: 1) the financial statements and 2) notes to the financial statements that explain in more detail some of the information in the financial statements.

### **REQUIRED FINANCIAL STATEMENTS**

The financial statements of the District report information about the District using accounting methods similar to those used by the private-sector companies. These statements provide both long-term and short-term information about the District's overall financial status.

The Statement of Net Assets presents information on all of the District's assets and liabilities, with the difference between the two reported as net assets. This statement provides information about the nature and the amounts of investments in resources(assets) and the obligations to District creditors (liabilities). It provides one way to measure the financial health of the District by providing the basis for evaluating the capital structure of the District and assessing the liquidity and financial flexibility of the District. However, there are several outside nonfinancial factors that need to be considered. Factors such as changing economic conditions, population and customer growth, and new or changed rules and regulations.

All of the current year's revenue and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Assets. This statement measures the success of the District's operations over the past year and can be used to determine whether the District has successfully recovered all its cost through its user fees.

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. This statement provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

### **FINANCIAL ANALYSIS OF THE DISTRICT**

#### **Net Assets**

As previously noted, net assets may serve over time as a useful indicator of an entity's financial position. In the case of the District, assets exceeded liabilities by \$430,392,000 at the close of the most recent fiscal year. As can be seen in Table A , on the next page, the largest portion of the District's net assets (68%) reflect its investment in capital assets (e.g., sewers, buildings, machinery and equipment), less any related debt used to acquire those assets that is still outstanding. These

capital assets are used primarily in the collection and treatment of wastewater throughout the District's service area. The related debt will be repaid with resources provided by system users through rates and fees.

**Table A**  
**Condensed Summary of Net Assets**  
**(In Thousands)**

	<b>2002</b>	<b>2001</b>	<b>Increase (Decrease) over 2001</b>	<b>Percentage Increase (Decrease)</b>
Current and Other Assets	\$206,287	\$ 221,129	\$ (14,842)	(6.7%)
Capital Assets	<u>681,288</u>	<u>668,565</u>	<u>12,723</u>	<u>1.9%</u>
Total Assets	<u>887,575</u>	<u>889,694</u>	<u>(2,119)</u>	<u>(0.2%)</u>
Long-term Debt				
Outstanding	438,838	455,696	(16,858)	(3.7%)
Other Liabilities	<u>18,345</u>	<u>16,364</u>	<u>1,981</u>	<u>12.1%</u>
Total Liabilities	<u>457,183</u>	<u>472,060</u>	<u>(14,877)</u>	<u>(3.2%)</u>
Invested in Capital Assets,				
Net of Related Debt	291,490	259,910	31,580	12.2%
-Restricted	4,565	4,880	(315)	(6.5%)
-Unrestricted	<u>134,337</u>	<u>152,844</u>	<u>(18,507)</u>	<u>(12.1%)</u>
Total Net Assets	<u>\$430,392</u>	<u>\$ 417,634</u>	<u>\$ 12,758</u>	<u>3.1%</u>

Net assets increased \$12.758 million in 2002. The increase is a combination of income before contributions and contributions in the form of connection fees, assessments, and developer contributions.

**Table B**  
**Condensed Summary of Revenues,**  
**Expenses, and Changes in Net Assets**  
**(In Thousands)**

	<u>2002</u>	<u>2001</u>	<u>Increase (Decrease) over 2001</u>	<u>Percentage Increase (Decrease)</u>
Operating revenues	\$ 121,447	\$ 114,109	\$ 7,338	6.4%
Nonoperating revenues	<u>7,449</u>	<u>7,279</u>	<u>170</u>	2.3%
Total revenues	<u>128,896</u>	<u>121,388</u>	<u>7,508</u>	6.2%
Depreciation expense	27,271	27,212	59	0.2%
Other operating expense	75,436	70,312	5,124	7.3%
Nonoperating expense	<u>21,745</u>	<u>19,525</u>	<u>2,220</u>	11.4%
Total expenses	<u>124,452</u>	<u>117,049</u>	<u>7,403</u>	6.3%
Income (Loss) before Capital contributions	4,444	4,339	105	2.4%
Capital contributions	<u>8,314</u>	<u>10,246</u>	<u>(1,932)</u>	(18.9%)
Changes in net assets	12,758	14,585	(1,827)	(12.5%)
Beginning net assets	<u>417,634</u>	<u>403,049</u>	<u>14,585</u>	3.6%
Ending net assets	<u>\$ 430,392</u>	<u>\$ 417,634</u>	<u>\$ 12,758</u>	3.1%

While the Summary of Net Assets (Table A) shows the change in financial position of net assets, the Summary of Revenues, Expenses, and Changes In Net Assets provides details as to the nature and source of these changes. Table B shows that total revenues increased 6.2 percent or \$7.5 million and expenses increased 6.3 percent or \$7.4 million. The major factors which contributed to these results, include:

- Operating revenues reflect a 6 percent rate increase implemented January 9, 2002.
- Nonoperating revenues increased 2.3 percent but this is primarily an offset between an increase in the fair value of investments and a decrease in investment income due to declining interest rates and a rebate payment.
- Operating expenses increased 7.3 percent or \$5.124 million. Personnel and related costs increased \$1.9 million with increases in health care costs, basic wage increases, and retirements. Other increases occurred in billing services, security costs, repair and maintenance efforts, computer and process systems, regulatory negotiations, and environmental studies.

- Nonoperating expenses increased 11.4 percent or \$2.22 million resulting from a full year of interest expense on the November 2001 bond issue.
- Capital contributions will fluctuate depending on building activity and assessment projects.

## BUDGETARY HIGHLIGHTS

The District has an annual operating budget that is approved by the Hamilton County Board of County Commissioners. Capital budgets are approved on a project basis, however; annually a current year and a five year plan is presented to the Board. The 2002 sewerage charges budget prepared in part from previous rate studies was about 6 percent under budget. A new rate study which addressed this issue has been completed and implemented for 2003. Expenses were 4.5 percent under the approved budget with most of the savings in personnel and personnel related categories. Additional savings, \$3.6 million, were realized when a proposed bond issue was not needed.

## CAPITAL ASSETS AND DEBT ADMINISTRATION

### **Capital Assets**

As of December 31, 2002, the District's investment in capital assets amounted to \$681 million (net of accumulated depreciation) as shown in Table C. During the year the District spent about \$32 million on capital improvement projects and received about \$8 million in capital contributions. Most of the projects involved sewer replacements and improvements with the largest project being the System Wide Modeling project, \$3.9 million.

**Table C**  
**Capital Assets**  
**(In Thousands)**

	2002	2001	Increase (Decrease) over 2001	Percentage Increase (Decrease)
Land	\$ 4,977	\$ 4,932	\$ 45	0.91%
Buildings & Structures	621,759	600,363	21,396	3.56%
Processing Systems	257,417	258,181	(764)	(0.30%)
Office & Service Equipment	29,221	28,225	996	3.53%
Construction in progress	<u>167,080</u>	<u>150,511</u>	<u>16,569</u>	11.01%
Subtotal	1,080,454	1,042,212	38,242	3.67%
Less Accumulated Depreciation	<u>399,166</u>	<u>373,647</u>	<u>25,519</u>	6.83%
Net Capital Assets	<u>\$ 681,288</u>	<u>\$ 668,565</u>	<u>\$ 12,723</u>	1.90%

## **Debt Administration**

The District finances its construction program primarily through the issuance of revenue bonds. In addition, the District will utilize low interest loan programs through the State of Ohio where appropriate.

The District's revenue bond ratings are:

Moody's Investors Services	Aa3
Standard & Poor's Corporation	AA

Additional information on the District's long-term debt can be found in note 6 to the financial statements.

## **ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES**

The service area of the District is best described as mature. The District is not in a growth situation but one in which the system, generally, is being upgraded and replaced to comply with increasing regulatory requirements. The operating budget for 2003 is \$129,459,680 which is \$1.6 million less than the 2002 budget. A rate increase of 7 percent was approved effective January 9, 2003.

The capital plan was submitted and accepted for the years 2003 through 2007. The plan contemplates issuing an average of about \$60 million in debt each year to finance the capital improvement program. Each project must be individually approved before proceeding.

**THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI**  
**STATEMENTS OF NET ASSETS**  
**December 31, 2002 and 2001**  
(all amounts expressed in thousands)

**ASSETS**

	<u>2002</u>	<u>2001</u>
<b>Current assets</b>		
Cash, cash equivalents and pooled investments held by the City of Cincinnati	\$ 12,782	\$ 11,869
Accounts receivable	21,057	17,968
Prepaid expenses and other	<u>2,443</u>	<u>3,100</u>
<b>Total current assets</b>	<b>36,282</b>	<b>32,937</b>
 <b>Noncurrent assets:</b>		
<b>Restricted assets:</b>		
Cash, cash equivalents and pooled investments held by the City of Cincinnati:		
Construction account	9,947	4,247
Amount to be transferred to surplus account	6,371	10,539
Held by trustee:		
Cash and cash equivalents	33,826	22,549
Investments - Held to maturity	<u>112,245</u>	<u>142,742</u>
<b>Total restricted assets</b>	<b>162,389</b>	<b>180,077</b>
 <b>Other assets:</b>		
Unamortized financing costs	5,064	5,484
Other	<u>2,552</u>	<u>2,631</u>
<b>Total other assets</b>	<b>7,616</b>	<b>8,115</b>
 <b>Capital assets:</b>		
Land	4,977	4,932
Building and structures	621,759	600,363
Processing systems	257,417	258,181
Office and service equipment	29,221	28,225
Construction in progress	<u>167,080</u>	<u>150,511</u>
	<u>1,080,454</u>	<u>1,042,212</u>
 Less accumulated depreciation	(399,166)	(373,647)
 Net capital assets	681,288	668,565
 <b>Total noncurrent assets</b>	<b>851,293</b>	<b>856,757</b>
 <b>Total assets</b>	<b>\$ 887,575</b>	<b>\$ 889,694</b>

The notes to the financial statements are an integral part of the financial statements.

**THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI**  
**STATEMENTS OF NET ASSETS**  
**December 31, 2002 and 2001**  
**(all amounts expressed in thousands)**

<b>LIABILITIES</b>	<b>2002</b>	<b>2001</b>
<b>Current liabilities:</b>		
Payable from current assets:		
Current portion of long-term debt	\$ 18,070	\$ 17,026
Accounts payable	3,924	4,094
Accrued payroll expenses	<u>1,139</u>	<u>1,017</u>
Total current liabilities payable from current assets	<u>23,133</u>	<u>22,137</u>
Payable from restricted assets:		
Construction accounts payable	5,178	3,410
Accrued interest payable	<u>1,828</u>	<u>2,044</u>
Total current liabilities payable from restricted assets	<u>7,006</u>	<u>5,454</u>
<b>Total current liabilities payable from current and restricted assets</b>	<b><u>30,139</u></b>	<b><u>27,591</u></b>
<b>Noncurrent Liabilities:</b>		
Accrued compensated absences	6,276	5,799
Long-term debt	<u>420,768</u>	<u>438,670</u>
<b>Total noncurrent liabilities</b>	<b><u>427,044</u></b>	<b><u>444,469</u></b>
<b>Total liabilities</b>	<b><u>457,183</u></b>	<b><u>472,060</u></b>
<b>Net assets</b>		
Invested in capital assets, net of related debt	291,490	259,910
Restricted for debt service	4,565	4,880
Unrestricted	<u>134,337</u>	<u>152,844</u>
<b>Total net assets</b>	<b><u>\$ 430,392</u></b>	<b><u>\$ 417,634</u></b>

The notes to the financial statements are an integral part of the financial statements.

**THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI  
STATEMENTS OF REVENUES, EXPENSES  
AND CHANGES IN NET ASSETS  
for the years ended December 31, 2002 and 2001  
(all amounts expressed in thousands)**

	<u>2002</u>	<u>2001</u>
<b>Operating revenues:</b>		
Sewerage service charges	\$ 107,899	\$ 101,634
Sewer surcharges	10,841	9,716
All other revenues	<u>2,707</u>	<u>2,759</u>
<b>Total operating revenues</b>	<b><u>121,447</u></b>	<b><u>114,109</u></b>
<b>Operating expenses:</b>		
Personnel services	35,244	33,351
Purchased services	18,814	15,823
Utilities, fuel and supplies	15,506	15,807
Depreciation	27,271	27,212
Other expenses	<u>5,872</u>	<u>5,331</u>
<b>Total operating expenses</b>	<b><u>102,707</u></b>	<b><u>97,524</u></b>
<b>Operating income</b>	<b><u>18,740</u></b>	<b><u>16,585</u></b>
<b>Nonoperating revenues (expenses):</b>		
Interest income	4,861	7,930
Change in fair value of investments	2,493	(723)
Interest expense	(21,745)	(19,525)
Gain on sale of fixed assets	<u>95</u>	<u>72</u>
<b>Total nonoperating revenues (expenses)</b>	<b><u>(14,296)</u></b>	<b><u>(12,246)</u></b>
<b>Income from operations</b>	<b>4,444</b>	<b>4,339</b>
Capital contributions	<u>8,314</u>	<u>10,246</u>
<b>Change in net assets</b>	<b>12,758</b>	<b>14,585</b>
<b>Total net assets, beginning</b>	<b><u>417,634</u></b>	<b><u>403,049</u></b>
<b>Total net assets, ending</b>	<b><u>\$ 430,392</u></b>	<b><u>\$ 417,634</u></b>

The notes to the financial statements are an integral part of the financial statements.

**THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI  
STATEMENTS OF CASH FLOWS  
for the years ended December 31, 2002 and 2001  
(all amounts expressed in thousands)**

	<u>2002</u>	<u>2001</u>
<b>Cash Flows from Operating Activities</b>		
Cash received from customers	\$ 115,651	\$ 111,361
Cash payments for goods and services	(40,433)	(35,869)
Cash payments for personnel costs	(34,645)	(34,068)
Other operating revenues	<u>3,461</u>	<u>2,169</u>
<b>Net Cash Provided by Operating Activities</b>	<u><u>44,034</u></u>	<u><u>43,593</u></u>
<b>Cash Flows from Capital and Related Financing Activities</b>		
Principal and interest payments on long-term debt	(40,976)	(51,126)
Acquisition and construction of capital assets	(32,277)	(34,619)
Loan proceeds	287	2,175
Revenue bond proceeds	-	76,128
Revenue bond issuance costs	(40)	(667)
Tap-in fees	4,202	4,486
Proceeds from sale of property, plant and equipment	<u>95</u>	<u>72</u>
<b>Net Cash (Used) by Capital and Related Financing Activities</b>	<u><u>(68,709)</u></u>	<u><u>(3,551)</u></u>
<b>Cash Flows from Investing Activities</b>		
Purchase of government securities	(228,048)	(143,186)
Maturity or redemption of government securities	260,980	114,463
Net increase in fair value of pooled cash and investments held by City of Cincinnati	58	163
Interest earned on investments	<u>5,407</u>	<u>9,674</u>
<b>Net Cash Provided (Used) by Investing Activities</b>	<u><u>38,397</u></u>	<u><u>(18,886)</u></u>
<b>Net Increase (Decrease) in Cash and Cash Equivalents</b>	<u><u>13,722</u></u>	<u><u>21,156</u></u>
<b>Cash and Cash Equivalents at January 1</b>	<u><u>49,204</u></u>	<u><u>28,048</u></u>
<b>Cash and Cash Equivalents at December 31</b>	<u><u>\$ 62,926</u></u>	<u><u>\$ 49,204</u></u>
<b>Reconciliation of Operating Income to Net Cash Provided by Operating Activities:</b>		
Income from operations	\$ 18,740	\$ 16,585
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	27,271	27,212
Change in assets and liabilities:		
Net change in customer accounts receivable	(3,089)	11
Net change in other assets	683	(666)
Net change in operating accounts payable	(170)	1,168
Net change in accrued payroll and related expenses	<u>599</u>	<u>(717)</u>
<b>Net Cash Provided by Operating Activities</b>	<u><u>\$ 44,034</u></u>	<u><u>\$ 43,593</u></u>
<b>Non-cash Transactions:</b>		
Structures donated as contributed capital in aid of construction	<u><u>\$ 3,261</u></u>	<u><u>\$ 5,160</u></u>

**THE METROPOLITAN SEWER DISTRICT OF GREATER CINCINNATI  
NOTES TO THE FINANCIAL STATEMENTS  
for the years ended December 31, 2002 and 2001**

**NOTE 1 - ACCOUNTING POLICIES**

A summary of the significant accounting policies applied in the accompanying financial statements follows:

**Organization**

The Metropolitan Sewer District of Greater Cincinnati (MSD), an enterprise fund of the County of Hamilton, Ohio, collects and treats industrial and residential wastewater for municipalities and unincorporated areas of Hamilton County. MSD was formed on April 10, 1968, pursuant to resolutions of the Board of County Commissioners of Hamilton County and Ordinances of the City of Cincinnati, providing for a consolidation of the City Sewer Department and the County Sewer District. Under a contract with the City of Cincinnati, the Board designated the City as its agent for the maintenance and operation of MSD. The annual budget, prepared on the cash basis of accounting, is approved by the Board and administered by the City. Budgetary control is exercised at the divisional level, and between personnel and all other costs. The County issues a separate Comprehensive Annual Financial Report which includes MSD as a separate enterprise fund of the County.

**Basis of Accounting**

The accompanying financial statements were prepared on the accrual basis of accounting, whereby revenues and expenses are recognized in the period earned or incurred.

**Enterprise Fund Activity Accounting and Financial Reporting**

In accordance with GASB Statement No. 34, "Basic Financial Statements and Management's Discussion and Analysis for State and Local Government, the District applies all GASB pronouncements and all FASB Statements and Interpretations, Accounting Principles Board of Opinions and Accounting Research Bulletins issued on or before November 30, 1989, unless they conflict with GASB pronouncements.

**Use of Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements

and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### **Statement of Cash Flows**

For purposes of the Statements of Cash Flows, all highly liquid investments with a maturity of three months or less when purchased are considered to be cash equivalents. Pooled cash and investments held by the City of Cincinnati are considered cash equivalents by MSD.

### **Investments**

MSD is required by Ohio law to invest in only United States obligations; federal agency securities; Ohio bonds and other obligations or such obligations of political subdivisions of the state, provided that the subdivisions are located within Hamilton County; time certificates of deposit or deposit accounts in an eligible institution; and no load money market mutual funds consisting only of investments mentioned above. Investments are required to mature within five years from the date of settlement, unless the investment is matched to a specific obligation or debt of MSD.

Investment securities are stated at fair value in accordance with GASB Statement No. 31.

### **Inventory**

Supplies and materials are stated at the lower cost or market on a first-in, first-out (FIFO) basis.

### **Capital Assets**

Capital assets are stated at historical cost for assets acquired after MSD's inception in 1968. Assets which were acquired prior to 1968 and not identifiable with specific historical costs are not included in the capital assets balance. Assets acquired by MSD through contributions, such as contributions from land developers and federal and state grants, are capitalized and recorded in the plant records at the contributors' reported cost. Construction costs include interest capitalized on debt during the period of construction and the cost of in-force labor.

Depreciation expense is computed on the straight-line method over the estimated useful lives of the respective assets. The estimated lives are as follows:

Building and structures	40 years
Processing systems	25 years
Office and service equipment	5-15 years

Any gain or loss arising from the disposal of capital assets has been credited or charged to income.

### **Unamortized Financing Costs**

The unamortized financing costs include bond discount, consulting and attorney fees incurred in connection with the revenue bond obligations. These amounts are being amortized on the interest method and the straight-line method, respectively, over the lives of the revenue bonds.

### **Pension Plans**

Employees participate in either the City of Cincinnati's Retirement System or the Public Employees Retirement System administered by the State of Ohio. Pension costs reflect a percentage of employees' gross pay, as defined by the terms of pension plans in which employees participate. MSD's policy is to fund pension costs accrued.

### **Compensated Absences**

Compensated absences are accrued in accordance with GASB Statement No. 16. Components of the liability include accrued vacation time, sick leave, compensatory time and other related payments.

### **Net Assets**

Net assets are the difference between assets and liabilities. Net assets invested in capital asset, net of related debt are capital assets less accumulated depreciation and any outstanding long-term debt related to the acquisition, construction or improvement of those assets. Net assets are reported as restricted when there are legal limitations that are imposed on their use by county legislation or external restrictions by other governments, creditors or grantors.

### **Operating Revenues and Expenses**

Operating revenues are those revenues that are generated directly from the primary activity of the proprietary fund. For the District, these revenues are charges for services for wastewater treatment. Operating expenses are necessary costs incurred to provide the service that is the primary activity of the fund.

## NOTE 2 - DEPOSITS AND INVESTMENTS

The following information classifies deposits and investments by category of risk as defined in GASB Statement No. 3, "Deposits with Financial Institutions, Investments and Repurchase Agreements"

**Deposits:** At December 31, 2002 and 2001, the carrying amount of MSD's deposits held by the City of Cincinnati total \$29,100,000 and \$26,655,000 respectively. Amounts held by the City of Cincinnati are invested on MSD's behalf in accordance with the Cincinnati Municipal Code. Amounts held by the City are collateralized as part of the City's cash and investment balances.

**Investments:** Funds held by trustees are eligible investments as defined by the Trust Agreement and are in the name of the trustee for the benefit of MSD.

Investments made by MSD are summarized below. Trustee account investments are categorized according to credit risk into the following categories: (1) insured or registered, or securities held by MSD's or its agent (bank trust department) in the MSD's name; or (2) uninsured and unregistered, with securities held by the counterparty's trust department or agent in the MSD's name; or (3) uninsured, unregistered securities held by the counterparty, or its trust department or agent but not in MSD's name. Money market funds are unclassified investments since they are not evidenced by securities that exist in physical or book entry form.

<u>December 31, 2002</u>	(all amounts in thousands)			<u>Carrying Amount</u>	<u>Fair Value</u>
	<u>Category</u>	<u>1</u>	<u>2</u>	<u>3</u>	
U.S. Government Securities	\$ 112,245	\$ -	\$ -	\$ 112,245	\$ 112,245
Money Market Funds				33,826	33,826
Total	<u>\$ 112,245</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 146,071</u>	<u>\$ 146,071</u>

<u>December 31, 2001</u>	(all amounts in thousands)			<u>Carrying Amount</u>	<u>Fair Value</u>
	<u>Category</u>	<u>1</u>	<u>2</u>	<u>3</u>	
U.S. Government Securities	\$ 142,742	\$ -	\$ -	\$ 142,742	\$ 142,742
Money Market Funds				22,549	22,549
Total	<u>\$ 142,742</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 165,291</u>	<u>\$ 165,291</u>

The classification of cash and cash equivalents and investments on the financial statements is based on criteria set forth in GASB Statement No. 9. A reconciliation between the classifications of cash and investments on the financial statements and the classification per GASB Statement No. 3 is as follows:

(all amounts in thousands)		
<u>December 31, 2002</u>	<u>Cash and Cash Equivalents</u>	<u>Investments</u>
GASB Statement No. 9	\$ 62,926	\$ 112,245
Money Market Funds	<u>(33,826)</u>	<u>33,826</u>
GASB Statement No. 3	<u>\$ 29,100</u>	<u>\$ 146,071</u>

  

<u>December 31, 2001</u>	<u>Cash and Cash Equivalents</u>	<u>Investments</u>
GASB Statement No. 9	\$ 49,204	\$ 142,742
Money Market Funds	<u>(22,549)</u>	<u>22,549</u>
GASB Statement No. 3	<u>\$ 26,655</u>	<u>\$ 165,291</u>

### **NOTE 3 - ACCOUNTS RECEIVABLE**

Accounts receivable consist of the following:

	(all amounts in thousands)	
	<u>December 31,</u>	<u>2002</u>
Sewerage charges and surcharges:		
Unbilled amount	\$ 11,278	\$ 10,484
Billed amount	11,054	8,329
Less allowance for doubtful accounts	(1,585)	(1,600)
Other	<u>310</u>	<u>755</u>
Total	<u>\$ 21,057</u>	<u>\$ 17,968</u>

### **NOTE 4 - RESTRICTIONS ON ASSETS**

Land acquired for MSD's use is titled to either the City of Cincinnati or Hamilton County. The cost of this land has been recorded on the books of MSD since it has the full benefit of the land as an economical resource.

In August 1985, the Federal District Court entered a consent order in an action with MSD and others (see Commitments and Contingencies Note). In complying with the consent order, MSD is required to maintain amounts on deposit in an environmental security account. Expenditures from this account must be approved by the U.S. Environmental Protection Agency. The balance of this account, which is included in other assets, was \$1,166,000 and \$1,144,000 at December 31, 2002 and 2001, respectively.

The Trust Agreement for the Series A Revenue Bonds (see Long-Term Debt Note) requires the establishment of certain trust accounts including a Bond Account, Bond Reserve Account, Replacement and Improvement Account, and a Surplus Account to be held by the Trustee. The Bond Account will be used to accumulate periodic principal and interest payments. The Bond Reserve Account will be funded in an amount equal to the highest annual future debt service requirement. The Replacement and Improvement Account is to be maintained with a balance of \$5,000,000. The Surplus Account is available to be used for any other Sewer System purpose. The Trust Agreement also requires the creation of a Construction Account to be held by the City to pay for project costs. At December 31, 2002 and 2001 the following balances (at fair value) were maintained in the trust accounts:

	(all amounts in thousands)	
	<u>December 31,</u>	
	<u>2002</u>	<u>2001</u>
<b>Held by trustee:</b>		
Reserve	\$ 44,037	\$ 41,933
Replacement and improvement	5,004	5,109
Bond retirement	3,399	3,736
Surplus	<u>93,631</u>	<u>114,513</u>
Total	<u>\$ 146,071</u>	<u>\$ 165,291</u>

**NOTE 5 - CAPITAL ASSETS**

The following summarized the changes to capital assets during 2002.

	(all amounts in thousands)			
	<u>Balance at January 1, 2002</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at December 31, 2002</u>
Land	\$ 4,932	\$ 45	\$ -	\$ 4,977
Buildings and structures	600,363	21,396	-	621,759
Processing systems	258,181	286	(1,050)	257,417
Office and service equipment	<u>28,225</u>	<u>1,559</u>	<u>(563)</u>	<u>29,221</u>
	<u>\$ 891,701</u>	<u>\$ 23,286</u>	<u>\$ (1,613)</u>	<u>913,374</u>
Accumulated depreciation				(399,166)
Net capital assets				<u>\$ 514,208</u>
Construction in progress as of January 1, 2002				\$ 150,511
Additions				38,686
Construction Projects closed				(22,117)
Construction in progress as of December 31, 2002				<u>\$ 167,080</u>
	(all amounts in thousands)			
	<u>Accumulated Depreciation</u>			
	<u>Balance at January 1, 2002</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at December 31, 2002</u>
Land	\$ -	\$ -	\$ -	\$ -
Buildings and structures	236,239	14,319	-	250,558
Processing systems	115,403	9,686	-	125,089
Office and service equipment	<u>22,005</u>	<u>2,075</u>	<u>561</u>	<u>23,519</u>
	<u>\$ 373,647</u>	<u>\$ 26,080</u>	<u>\$ 561</u>	<u>\$ 399,166</u>

The following summarized the changes to capital assets during 2001.

	(all amounts in thousands)			
	Balance at January 1, 2001	Additions	Deletions	Balance at December 31, 2001
Land	\$ 4,925	\$ 7	\$ -	\$ 4,932
Buildings and structures	567,218	33,145	-	600,363
Processing systems	259,089	138	(1,046)	258,181
Office and service equipment	<u>25,996</u>	<u>2,617</u>	<u>(388)</u>	<u>28,225</u>
	<u>\$ 857,228</u>	<u>\$ 35,907</u>	<u>\$ (1,434)</u>	<u>891,701</u>
Accumulated depreciation				(373,647)
Net capital assets				<u>\$ 518,054</u>
Construction in progress as of January 1, 2001				\$ 145,667
Additions				37,681
Construction Projects closed				<u>(32,837)</u>
Construction in progress as of December 31, 2001				<u>\$ 150,511</u>

	(all amounts in thousands)			
	Balance at January 1, 2001	Additions	Deletions	Balance at December 31, 2001
Land	\$ -	\$ -	\$ -	\$ -
Buildings and structures	222,621	13,618	-	236,239
Processing systems	105,143	10,260	-	115,403
Office and service equipment	<u>20,217</u>	<u>2,176</u>	<u>388</u>	<u>22,005</u>
	<u>\$ 347,981</u>	<u>\$ 26,054</u>	<u>\$ 388</u>	<u>\$ 373,647</u>

**NOTE 6 - LONG-TERM DEBT**

Long-term debt consisted of the following:

(all amounts in thousands except percents)				<u>December 31,</u>	
	<u>Principal Issue</u>	<u>Interest Rate</u>	<u>Year of Maturity</u>	<u>2002</u>	<u>2001</u>
<b>Series A Revenue Bonds</b>					
2001	\$ 76,000	2.30-5.25	2026	\$ 71,205	\$ 76,000
2000	40,085	4.50-5.75	2025	38,395	39,260
1997	105,245	3.85-5.13	2017	87,355	91,255
1995	85,800	3.70-6.05	2017	64,590	68,510
1993	171,790	2.45-5.60	2016	159,340	161,780
<b>Ohio Water Development Authority Contracts</b>	41,830	2.00-7.49	2019	1,335	1,656
<b>Ohio Water and Sewer Rotary Commission</b>	-	-	-	50	50
<b>Ohio Public Works Commission</b>	-	3.54-4.80	2017	4,440	4,677
<b>Water Pollution Control Loan Fund</b>	-	0.00-3.00	2018	<u>12,128</u>	<u>12,508</u>
<b>Total obligations</b>				\$ 438,838	\$ 455,696
<b>Less current maturities</b>				<u>(18,070)</u>	<u>(17,026)</u>
<b>Long-term portion</b>				<u>\$420,768</u>	<u>\$ 438,670</u>

Principal and interest payments on long-term debt for the next five years and thereafter are as follows:

Year	Revenue Bonds		OWDA		OPWC*		WPCLF*	
	Principal	Interest	Principal	Interest	Principal	Interest	Principal	Interest
2003	\$ 16,930	\$ 21,937	\$ 174	\$ 47	\$ 257	\$ 99	\$ 709	\$ 585
2004	17,805	21,068	99	42	276	96	738	555
2005	18,720	20,150	102	38	281	91	770	524
2006	19,695	19,172	106	35	287	85	802	492
2007	20,665	18,202	109	31	292	79	836	458
2008-2012	120,510	73,826	610	95	1,546	307	4,739	1,731
2013-2017	155,500	38,830	135	5	1,417	149	4,155	724
2018-2022	26,950	10,561	-	-	657	38	1,228	132
2023-2027	24,110	2,894	-	-	25	-	-	-
<b>Total</b>	<b><u>\$ 420,885</u></b>	<b><u>\$ 226,640</u></b>	<b><u>\$ 1,335</u></b>	<b><u>\$ 293</u></b>	<b><u>\$ 5,038</u></b>	<b><u>\$ 944</u></b>	<b><u>\$ 13,977</u></b>	<b><u>\$ 5,201</u></b>

\* This amount shown represents the total amount of the loans, some of which have not been fully drawdown or finalized.

<u>December 31, 2002</u>	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
Revenue Bonds	\$ 436,805	\$ -	\$ 15,920	\$ 420,885
Ohio Water Development Authority	1,656	-	321	1,335
Contracts				
Ohio Water and Sewer Rotary Commission	50	-	-	50
Ohio Public Works Commission	4,677	-	237	4,440
Water Pollution Control Loan Fund	<u>12,508</u>	<u>287</u>	<u>667</u>	<u>12,128</u>
Total	<u>\$ 455,696</u>	<u>\$ 287</u>	<u>\$ 17,145</u>	<u>\$ 438,838</u>

### **Series A Revenue Bonds**

Effective November 14, 2001, MSD issued \$76,000,000 County of Hamilton, Ohio 2001 Series A Sewer System Improvement and Refunding Revenue bonds dated November 1, 2001. The proceeds from the 2001 bonds were used to permanently fund certain previous capital expenditures, defease a portion of the 1991 Series A bond issue, fund the new bond reserve requirement and pay for the cost of issuance. The 2001 bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on a parity with the 1993, 1995, 1997 and 2000 Series A bonds, secured equally and ratably under the Trust Agreement.

Effective June 29, 2000, MSD issued \$40,085,000 County of Hamilton, Ohio 2000 Series A Sewer System Improvement Revenue bonds dated June 1, 2000. The proceeds from the 2000 bonds were used to permanently fund certain previous capital expenditures, fund the new bond reserve requirement and pay the cost of issuance. The 2000 bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on a parity with the 1993, 1995 and 1997 Series A bonds, secured equally and ratably under the Trust Agreement.

Effective October 22, 1997, MSD issued \$105,245,000 County of Hamilton, Ohio 1997 Series A Sewer System Improvement Revenue bonds dated October 1, 1997. The proceeds from the 1997 bonds were used to permanently fund certain previous expenditures, fund the new bond reserve requirement and pay the cost of issuance. The 1997 bonds are special obligations of the District, payable solely from the net revenues of the District and were issued on a parity with the 1993, and 1995 Series A bonds, secured equally and ratably under the Trust Agreement.

Effective August 31, 1995, MSD issued \$85,800,000 County of Hamilton, Ohio 1995 Series A Sewer System Improvement and Refunding Revenue bonds dated August 15, 1995. The proceeds from the 1995 bonds were used to permanently fund certain previous capital expenditures, provide funds for new projects, defease a portion of the 1986 and 1991 Series A bond issues, fund the new bond reserve requirement and pay the cost of issuance. The 1995 bonds are special obligations of the District payable solely from the net revenues of the District and were issued on a parity with the 1993 Series A bonds, secured equally and ratably under the Trust Agreement.

Effective May 4, 1993, MSD issued \$171,790,000 County of Hamilton, Ohio 1993 Series A Sewer System Improvement and Refunding Revenue bonds dated April 15, 1993. The proceeds from the 1993 Bonds were used to permanently fund certain previous capital expenditures, provide funds for new projects, defease a portion of the 1986 and 1991 Series A bond issues, fund the new bond reserve requirement, and pay the cost of issuance. The 1993 bonds are special obligations of the District payable solely from the net revenues of the District, secured equally and ratably under the Trust Agreement.

The 2001, 2000, 1997, 1995, and 1993 Bonds may be redeemed prior to their maturities in accordance with provisions of the bond resolutions. The redemption process for the bonds include declining premiums up to 2 percent of principal.

Maturities for bonds over the next five years and thereafter are shown below.

**(all amounts in thousands)**

	<b><u>2001 Bonds</u></b>	<b><u>2000 Bonds</u></b>	<b><u>1997 Bonds</u></b>	<b><u>1995 Bonds</u></b>	<b><u>1993 Bonds</u></b>
2003	\$ 5,225	\$ 905	\$ 4,075	\$ 4,160	\$ 2,565
2004	5,470	950	4,280	4,410	2,695
2005	5,720	995	4,495	4,680	2,830
2006	1,480	1,040	4,720	1,990	10,465
2007	1,525	1,095	4,930	2,090	11,025
2008-2012	8,670	6,345	28,415	12,360	64,720
2013-2017	10,895	8,225	36,440	34,900	65,040
2018-2022	16,175	10,775	-	-	-
2023-2027	<u>16,045</u>	<u>8,065</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<b><u>\$ 71,205</u></b>	<b><u>\$ 38,395</u></b>	<b><u>\$ 87,355</u></b>	<b><u>\$ 64,590</u></b>	<b><u>\$ 159,340</u></b>

Under the terms of the amended revenue bond trust indenture, MSD has agreed to certain covenants, among other things, to restrict additional borrowing, maintain rates sufficient to meet debt service requirements, and maintain specified fund balances under trust agreements.

The Revenue bond issues as discussed above contain covenants which require the MSD to maintain a level of debt service coverage. The following calculation reflects MSD's debt service coverage.

(all amounts in thousands except percents)

	<u>2002</u>	<u>2001</u>
<b>Revenues:</b>		
Total operating revenues	\$ 121,447	\$ 114,109
Interest income	4,861	7,929
Capitalized interest income	487	1,183
Tap-in/connection fees	4,202	4,486
Total pledged revenues	<u>130,997</u>	<u>127,707</u>
 Total operating and maintenance expenses less depreciation and amortization	(75,436)	(70,312)
Half of pledged revenues transferred to surplus account	<u>3,186</u>	<u>5,350</u>
 Net income available for debt service (a)	<u>\$ 58,747</u>	<u>\$ 62,745</u>
 Principal and interest requirements on revenue bonds (b)	<u>\$ 38,871</u>	<u>\$ 34,783</u>
 Principal and interest requirements on all obligations (c)	<u>\$ 40,859</u>	<u>\$ 36,923</u>
 <b>Debt service coverage:</b>		
Revenue Bonds (a) divided (b)	<u>150%</u>	<u>181%</u>
All obligations (a) divided (c)	<u>144%</u>	<u>170%</u>
Maximum debt service coverage required on revenue bonds	<u>125%</u>	<u>125%</u>

### **Ohio Water Development Authority Contracts**

All contracts between the Ohio Water Development Authority (OWDA) and the Metropolitan Sewer District require MSD to prescribe and charge such rates for sewer usage which are sufficient (after expenses of operation and maintenance) to pay principal and interest on OWDA contracts. The principal is repayable in equal semi-annual installments to maturity.

### **Ohio Water and Sewer Rotary Commission**

Advances from Ohio Water and Sewer Rotary Commission represent tap-in fees and acreage assessments to be forwarded to the Commission upon collection from customers. Such advances do not bear interest unless they are determined to be in default.

### **Ohio Public Works Commission**

The MSD has entered into agreements with the Ohio Public Works Commission (OPWC) for financing of certain qualified capital projects. As the projects progress the commitments are drawn

down as funds are paid by OPWC directly to the contractors. The principal is repayable in semi-annual installments to the date of maturity for each project.

### **Water Pollution Control Loan Fund**

The MSD has received low interest loan commitments from the Ohio Water Pollution Control Loan fund for certain qualified projects. As the projects progress the commitments are drawn down. The principal is repayable in semi-annual installments to the date of maturity for each project.

### **Interest on Long-Term Obligations**

The following interest costs were incurred and expensed or capitalized as part of the cost of MSD's additions to capital assets.

	(all amounts in thousands)	
	<u>2002</u>	<u>2001</u>
Interest incurred	\$ 23,937	\$ 22,437
Less interest capitalization	<u>(2,192)</u>	<u>(2,912)</u>
 Interest expense	 <u>\$ 21,745</u>	 <u>\$ 19,525</u>

### **NOTE 7 - PENSION AND RETIREMENT**

A limited number of MSD employees participate in the Public Employee' Retirement System administrated by the State of Ohio. PERS is not material to the financial statements of MSD and additional disclosures concerning PERS, including other post-employment benefit information, can be found in the plan's annual financial statements. Interested parties may obtain a copy by written request to 277 East Town Street, Columbus, Ohio 43215-4642 or by calling (614) 466-2085.

### **City of Cincinnati Retirement System**

The majority of MSD full-time employees participate in the Retirement System of the City of Cincinnati (CRS). CRS is a cost-sharing, multiple-employer, defined benefit, public employee retirement system. The plan provides retirement, disability and death benefits to plan members and beneficiaries. CRS also provides health care benefits to vested retirees. Benefits provided under the plan are established by the Cincinnati Municipal Code. CRS issues a separate, publicly available financial report that includes financial statements and required supplementary information. That report may be obtained from the City of Cincinnati Retirement System, 801 Plum Street, Cincinnati, Ohio 45202 or by calling (513) 352-3227.

The Cincinnati Municipal Code provides statutory authority for employee and employer contribution rates. For 2002 and 2001, the required, actuarially determined contribution rates were 7 percent for MSD and 7 percent for employees. MSD's contributions to CRS for the years ending December 31, 2002, 2001 and 2000 were \$1,963,000, \$1,931,000 and \$1,809,000, respectively, equal to the required contribution for each year.

## **Other Postemployment Benefit Information**

CRS provides hospital and surgical insurance to retired members who have earned fifteen years credited service at the time of termination or terminate after age sixty with five years credited service. Those who are receiving survivor benefits of eligible members are entitled to have their hospital and surgical insurance premiums paid by the CRS. When benefits would be reduced by reason of the retired member's eligibility for hospital and medical benefits under federal social security laws, CRS will pay whatever additional fees are required for the Federal medical coverage.

The health care coverage provided by the CRS is advance-funded on an actuarial determined basis as a portion of the employer contribution requirement to the System. The Cincinnati Municipal Code provides authority for employer contributions.

The actuarial assumptions used for the December 31, 2001, valuation of unfunded liabilities (latest information available) included an assumption recognizing medical benefits at current premium costs with projected increases of 7 percent per annum. The cost of coverage is recognized as an expense as claims are paid. CRS has 5,543 active contributing participants of which 619 are MSD employees. For 2001, MSD's contribution was 16 percent of the total employers' contribution.

## **NOTE 8 - RELATED PARTY TRANSACTIONS**

Cincinnati Water Works provides billing and collection services on customers' accounts for MSD. Fees for these services for 2002 and 2001 were \$4,235,000 and \$3,996,000 respectively. Fees are also paid to other municipalities and villages within Hamilton County for collection of sewerage bills.

The City of Cincinnati provides "overhead" services to MSD, such as check disbursement, investment and legal services, etc. The fees for these services for 2002 and 2001 were \$2,215,000 and \$2,099,000 respectively. In addition, the City's Municipal Garage provides gasoline and repairs vehicles for MSD. Fees for these services were \$1,123,000 and \$1,050,000 for 2002 and 2001, respectively.

## **NOTE 9 - COMMITMENTS AND CONTINGENCIES**

The City of Cincinnati and the Board of County Commissioners of Hamilton County, Ohio, are parties to a Federal Consent Order which was entered in 1985 in settlement of United States of America vs. The Board of County Commissioners of Hamilton, County, Ohio et al., Case No. C-1-85-0693. The City and County have continued in their efforts to negotiate an amendment to change certain construction schedules appearing in exhibits to that order. The City and County believe these changes are due to circumstances beyond the control of either, and are seeking approval of those schedule modifications from the United States Environmental Protection Agency. The consent order provides for stipulated penalties for failure to meet certain construction schedule deadlines but specifically contemplates that no such penalties will be collected from either defendant where the non-compliance was beyond the reasonable control of the defendants. In addition, according to MSD's Chief Legal Counsel, EPA has requested the payment of \$290,000 in stipulated penalties under the Consent Order for certain effluent limit excursions between 1988 and January 1, 1991.

The Consent order provides for stipulated penalties under certain conditions, and although the City and County have argued that no substantial penalties are appropriate, it appears that EPA does intend to extract some monetary payment for excursions. The City of Cincinnati and the Board of County Commissioners of Hamilton County, Ohio are parties to an Interim Partial Consent Decree on Sanitary Sewer Overflows, which was lodged on February 15, 2002, with the U.S. District Court for the Southern District of Western Division. This Decree provides for, among other things, the scheduled elimination of sixteen "highly active" sanitary sewer overflows. This Decree is being contested by a third party. Negotiations continue on other wastewater collection and treatment issues, including combined sewer overflows.

As part of MSD's capital improvement program, MSD has entered into a number of contracts for construction, design, and other services. Commitments under these contracts aggregate approximately \$43 million as of December 31, 2002.

#### **NOTE 10 - RISK MANAGEMENT**

MSD records an estimated liability for indemnity health care, workers' compensation, torts and other claims against them. Claims liabilities are based on estimates of the ultimate cost of reported claims (including future claim adjustment expenses) and an estimate for claims incurred but not reported based on historical experience claims liabilities include specific, incremental claim adjustment expenses, allocated loss adjustment expenses, and are reduced for estimated recoveries on unsettled claims such as salvage or subrogation.

#### **NOTE 11 - SUBSEQUENT EVENTS**

The Hamilton County Board of Commissioners have approved a seven percent sewerage rate increase effective January 9, 2003.

#### **NOTE 12 - PRIOR YEAR RESTATEMENTS**

In 2002, the District implemented GASB Statement No. 34, "Basic Financial Statements - Management's Discussion and Analysis for State and Local Governments", GASB Statement No. 37, "Basic Financial Statements - and Management's Discussion and Analysis - For State and Local Governments: Omnibus," and GASB Statement No. 38, "Certain Financial Statement Note Disclosures." The primary impact of adopting the statements included changing the presentation of fund equity to net assets and the presentation of "Management's Discussion and Analysis".